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DOC FOR USPTO-PAUL SALMON
DOJ FOR MARIE-FLORE KOUAME
TREASURY FOR RHALL, DPETERS
STATE PASS EXIM FOR JRICHTER
STATE PASS OPIC FOR ZHAN, MSTUCKART, JEDWARDS
STATE PASS TDA FOR LFITTS, PMARIN

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SUBJECT: NIGERIA: U.S. TREASURY VISITOR HEARS STRENGTHS, WEAKNESSES OF BANKING SECTOR

Ref: A. ABUJA 119
¶B. LAGOS 201
¶C. LAGOS 97

¶1. (U) Summary: During June 19-20 meetings with Richard Hall, U.S. Department of Treasury, stakeholders in the Nigeria's banking and financial sectors identified several weaknesses: the banking sector's inability to absorb excess liquidity through sound medium to long term investments; bank asset overvaluation; under-developed risk management capacity; and untested management. These fundamental weaknesses could arrest, if not roll back, growth in the sector. End Summary.

¶2. (U) From June 19-20, Richard Hall, International Economist at the U.S. Department of Treasury, accompanied by Lagos and Abuja EconOffs, met with banks, infrastructure-financing institutions, private equity firms, and economic think tanks in Lagos to assess the health of Nigeria's financial sector. Participants included Mansur Ahmed, Director General of the Nigerian Economic Summit Group (NESG); Professor Doyin Salami of the Lagos Business School (LBS); Bismarck Rewane, Managing Director of Financial Derivatives; Richard Kramer, Chairman of the African Capital Alliance (ACA); Malcom Gilroy, Deputy Managing Director of Global Markets and Investment Banking, United Bank for Africa (UBA); Solomon Asamoah, Executive Vice President of the Africa Finance Corporation (AFC); Dr. Cecilia Ibru, Managing Director of Oceanic Bank; and Jubril Aku, Executive Director of Treasury and International Institutions, Ecobank.

Banks Healthy, Fighting for Market Share

¶3. (U) Jubril Aku, Executive Director for Treasury and International Institutions at Ecobank, told Hall that Nigerian banks were getting bigger and stronger; banking assets were doubling every two years; and lending to the private sector has more than doubled since consolidation. Following consolidation, Aku said 80 percent of banks were strong and sound, and only two banks were under interim management. When asked if Nigerian banks really need all the capital they have raised, Aku noted that not only were banks fearful of hostile takeovers, they were also gearing up to fight for greater market share. Aku thinks that bank earnings will come under greater pressure in 2009 from increasing competition and dwindling opportunities in the market. According to Aku, the industry's room for asset growth, except in the complex areas of power and

infrastructure finance, is fast reaching saturation point.

Bank Management Inexperienced, Untested

¶4. (U) Bismarck Rewane, Managing Director of Financial Derivatives; Richard Kramer, Chairman of the African Capital Alliance (ACA); and Malcom Gilroy, Deputy Managing Director of Global Markets and Investment Banking, United Bank for Africa (UBA) voiced concerns about the banks' human capacity, especially in light of potential downturns in the medium to long term future. Rewane said a "rising tide" in the banking sector brought everybody up with it; as a result, bankers have not yet been put to the test. Kramer believes there is much "froth" in the market, and a looming financial "storm" will weed out the good from the bad. Because Nigerian banks were small, poorly managed, and not exposed to complex deals, Gilroy pointed out the need for these banks to build capacity and international alliances in order to meet global competition and best practices. Senior-level management is not experienced enough to handle the post-consolidation banks' massive sizes, Gilroy said. Not even a handful of bank managers have ever made "meaningful decisions"; most of them have spent their entire career within Nigeria's bank industry doing basic trade finance, which gave them little scope for professional growth, he observed. The capacity gap between the upper echelon in management and the rest of the organization is another area of concern. Using Zenith Bank as an example, Kramer said Zenith's performance and future are too dependent on its current, highly competent Managing Director.

Banks Ill-Equipped For Infrastructure Development
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¶5. (U) Solomon Asamoah, Executive Vice President of the Africa Finance Corporation (AFC); Mansur Ahmed, Director General of the Nigerian Economic Summit Group (NESG); and Gilroy agreed that private public partnership (PPP) is the way forward for infrastructure development. Financing is no longer the issue given the liquidity in the market; instead, the technical ability required of the government and private partners to structure and get projects off the ground is the biggest hurdle, the executives said. They all expressed concerns about the banks' forays into infrastructure financing and their ability to do so safely. According to Gilroy's estimate, only about four Nigerian banks are capable of structuring sophisticated infrastructure transactions. ACA Chairman Dick Kramer echoed this assessment. He believes there are only several banks capable of such transactions in Nigeria, including First Bank, Guarantee Trust Bank, and Stanbic IBTC Bank.

Bank Weaknesses: "Borrowed" Capital, Margin Lending
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¶6. (U) Some interlocutors contended the banking sector is grossly overvalued and exhibits fundamental weaknesses. Rewane speculated that 50 percent of the capital banks raised during consolidation was not "genuine capital", but rather "borrowed capital" and claimed that 18 to 20 percent of the Nigerian Stock Exchange's (NSE) market capitalization was based on bank loans. He predicted the banks will go back to the market again to fill the gap created by the "borrowed capital". In addition, many banks habitually lend people money to buy the banks' own shares and then use these shares as collateral, Rewane noted (Reftel C). He also sees banks venturing into uncharted territory as a direct result of not knowing what to do with their liquidity. Given these weaknesses in the system, Ahmed expressed concerns about the health of the banking sector and macro-economy. Dr. Cecilia Ibru, Managing Director of Oceanic Bank, shared his assessment, noting that, with the fluidity in the market and the massive amount of capital available to be deployed, the banking sector cannot afford to take a wrong turn.

¶7. (U) Contrary to other stakeholders' views, Gilroy argued that Nigerian bank stocks are not really over-valued. The returns are still good, and the economy is still growing, he said. Gilroy contended the concern about liquidity in the market is exaggerated, and attributed liquidity growth to the growth of bank capital and to

the Federation Account's allocations. (Note: The Federation Account collects almost all revenues collected by the Government of Nigeria, and funds in the account are distributed monthly to the Federal, state, and local governments in accordance with the revenue allocation formula approved by the National Assembly. The governments, in turn, deposit the allocation in banks. (Reftel A) End Note) He claimed that, since the allocations are short-lived, there is no reason to worry about inflation. Ten percent of the money flows out of the financial system, but a lot more flows into the bond and capital markets, he estimated. (Note: Transactions not channeled through banks or are conducted in the informal sector are considered outside the financial system. Capital flows into Nigeria's bond and capital markets, although passing through banks, do not stay long enough to significantly influence total bank deposit liabilities and, therefore, to increase bank capacity to create loans. As a result, what ordinarily could have become inflation will appear as "price pressure" in the capital market. End Note)

Banks Need to Develop Risk Management Capacity
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¶8. (U) UBA's Gilroy expressed grave concerns about the fragile and underdeveloped risk management capacity in the industry. He suggested that a few banks may be propping up their stock prices to inflate their balance sheets. Presently most mega loans in the industry are new and short term, which give banks a window of comfort, he added. Given the recent growth of the banking sector, Gilroy thinks the current level of knowledge about handling risk management at most banks will suffice for the short term. However, as the market matures and becomes increasingly sophisticated, he claimed the current risk management structure would not be able to

keep up.

¶9. (U) This cable has been cleared with Richard Hall and Embassy Abuja.

BLAIR